Supreme Court, U.S.
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No. _____

In The

Supreme Court of the United States

October Term, 1990

SECURITIES MANAGEMENT AND RESEARCH, INC., ET AL.,

Petitioners,

v.

CLINTON P. SWIFT, ET AL.,

Respondents.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Tenth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Can a district court impose sanctions under Rule 11 and under a state statute concerning vexatious claims where the complaint intentionally misrepresents material facts notwithstanding the fact that the complaint may assert some plausible legal theory?

2. Can a court of appeals reverse a district court's factual finding of an intentional misrepresentation of facts in a complaint?

3. Did the court of appeals, in reversing the district court, properly apply the "abuse of discretion" standard to the review of the lower court's factual findings and imposition of sanctions?

4. Can an intentional misrepresentation of facts in a complaint ever be justified under any legal theory?

PARTIES TO THE PROCEEDING

In addition to the parties identified in the caption to the Petition, Colonial National Bank (the "Bank") was a Plaintiff in the district court. The Bank's complaint was voluntarily dismissed pursuant to Fed. R. Civ. P. 41(a)(1)(i). The complaint was signed by its attorneys, Clinton P. Swift and Richard M. Lucas, of the lawfirm of Hall & Evans, P.C. At the dismissal hearing, Clinton P. Swift, Richard M. Lucas and Hall & Evans were represented by Bosworth & Towey, P.C.

Marilyn K. Bell and William E. Forman were third party defendants in the district court. Marilyn Bell who was voluntarily dismissed, was represented by Steven Cantrell, Esq. Willard E. Forman is in bankruptcy and is represented by Michael P. Bahr of Treece, Bahr & Arckey.

American National Income Fund, Inc., is also a petitioner herein and was a defendant in the district court. American National Income Fund, Inc. has no subsidiaries and has no parent corporation. Securities Management and Research, Inc. has no subsidiaries and is a wholly owned indirect subsidiary of American National Insurance Company.

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PETITION FOR WRIT OF CERTIORARI

Securities Management and Research, Inc. and American National Income Fund, Inc. respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Tenth Circuit.

OPINIONS BELOW

The ruling of the United States District Court for the District of Colorado granting sanctions (App. infra,

12a) was entered on December 27, 1988 and is not reported. The opinion of the United States Court of Appeals for the Tenth Circuit (App. infra, 16a-18a) was entered on July 11, 1990 but is not reported. The opinion of the United States Court of Appeals for the Tenth Circuit on rehearing (App. infra, 19a-20a) is not reported and was entered on September 18, 1990.

JURISDICTION

The judgment of the court of appeals was entered on July 11, 1990. The motion for rehearing with suggestion for partial rehearing en banc was overruled on September 18, 1990. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The district court considered an award of attorneys' fees under the following (quoted in relevant part):

Fed. R. Civ. P. 11

> The signature of an attorney or party constitutes a certificate by him that he has read the pleading . . . ; that to the best of his knowledge, information, and belief formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation . . . If a pleading, motion, or

> other paper is signed in violation of this rule, the court . . . shall impose upon the person who signed it, a represented party, or both, an appropriate sanction, which may include an order to pay to the other party or parties the amount of the expenses reasonably incurred because of the filing of the pleading, motion, or other paper including a reasonable attorney's fee.

Fed. R. Civ. P. 41(a)(2)

> . . . an action shall not be dismissed at the plaintiff's instance save upon order of the court and upon such terms and conditions as the court deems proper.

28 U.S.C. § 1927

> Any attorney or other person admitted to conduct cases in any court of the United States or any Territory thereof who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such conduct.

Colorado Revised Statutes §§ 13-17-101 et seq. (1987)

> . . . The Court shall assess attorneys' fees if . . . it finds that an attorney or party brought or defended an action, or any part thereof, that lacked substantial justification . . .

STATEMENT OF THE CASE

A. Background Facts.

In 1976, Willard and Charmaine Forman (the "Formans") as joint tenants, invested $50,000.00 in shares of

the American National Income Fund, Inc. (the "Fund"), through its transfer agent, Securities Management & Research, Inc. ("SM&R"). In April 1984, the Formans requested a total liquidation of their account and received all monies to which they were entitled. At the time of the liquidation, the Formans did not return one of the Fund certificates which had been provided to them while the account was active.

On May 13, 1985, Willard Forman borrowed $5,050.00 from Colonial National Bank (the "Bank"). As collateral for the note ("the 1985 Note"), Willard Forman pledged the worthless Fund certificate from the account which had previously been closed. As part of this loan transaction, a Regulation U Form was executed by the purported borrowers and acknowledged by the Bank's president, Mr. Wade. A paramour of Willard Forman, Marilyn Bell ("Bell"), testified that she forged Charmaine Forman's signature on the 1985 Note and Regulation U Form.

In January, 1986, Willard Forman borrowed money from the Bank in the name of M & W Enterprises ("M & W"). M & W was an entity formed by Willard Forman and Bell for the purpose of funding Canfield Roofing's overdrafts. Canfield Roofing was a company owned by Willard Forman. The note evidencing the debt ("the 1986 Note") was set up as a $60,000.00 line of credit with the initial draw in the approximate amount of $44,000.00.

At the time the 1986 Note was executed, Mr. Wade the president of the Bank, knew that Charmaine Forman had no interest in M & W. He also knew that Charmaine Forman had been separated from her husband for over two years and that Willard Forman was living with, and

having an affair with, Bell. Mr. Wade admitted that he had never seen or spoken to Charmaine Forman. When the 1986 Note was executed, the Bank took possession of the worthless Fund certificate, but did not have the Formans execute a stock transfer power.

When the 1986 Note was called for payment in late July, 1986, the obligors on that Note, Willard Forman and Bell, refused to pay. The Bank, on or about August 13, 1986, then requested that Willard Forman execute a stock transfer power and that he take the form to get his wife's signature. Willard Forman then had Bell forge his wife's signature on the stock transfer power. Such document was then redelivered to the Bank, which guaranteed the genuineness of both signatures. Such signatures were guaranteed by a Bank vice president despite the fact that she had not seen Charmaine Forman sign the document and, in fact, had never seen, spoken to, or met Charmaine Forman.

The Bank then informed SM&R that it had taken possession of the Fund certificate as a result of a default under the 1986 Note and demanded payment for all the Fund shares represented by the void certificate. On September 8, 1986, SM&R informed the Bank in writing that the certificate was void. On that same day, the Bank's president met with Willard Forman to discuss the situation. One of the matters discussed was the possibility of criminal charges.

B. The Actions of the Attorneys.

On September 24, 1986, the Bank, through its attorney, Clinton P. Swift ("Swift"), made demand on SM&R for payment of the market value of the Fund shares. Simultaneously, Swift began settlement negotiations with Willard Forman and Bell. Swift never informed SM&R about the settlement negotiations or the ultimate agreement reached. On November 25, 1986, the Bank, M & W, Willard Forman, Bell and Canfield Roofing agreed upon a settlement. The settlement agreement ("Agreement") expressly provided that the 1986 Note was canceled and replaced with a new note secured by new collateral. The Agreement provided that the Bank would bring a collection suit against SM&R.

The following year, Swift and Richard M. Lucas ("Lucas") signed a complaint and filed it against the Fund and SM&R. Such complaint stated that the Bank became the owner of the Fund certificate as a result of the default on the 1986 Note. The complaint intentionally omitted any reference to the existence of the Agreement or the fact that the 1986 Note had been canceled. Further, the complaint did not disclose that the balance owed on the 1986 Note was substantially less than the face amount of the line of credit and it did not reveal the existence of the replacement note upon which the obligors were current on all payments. The Agreement, as well as the forgeries, were uncovered by SM&R in pre-trial discovery.

The Bank, on February 29, 1988, moved to dismiss voluntarily its case against SM&R and the Fund. On March 11, 1988, SM&R and the Fund responded to the

motion to dismiss, requesting that as a condition of such dismissal that attorneys' fees, expenses and costs should be assessed against the Bank and its attorneys because of the misrepresentation of facts in the complaint. A trial on the issue of attorneys' fees was held on October 13-14, 1988. Following trial, in an eleven-page opinion, District Judge Matsch held, in part:

> "It is this court's finding that Clinton P. Swift violated Rule 11 when he signed a complaint which failed to discuss the settlement agreement. Half truths are not appropriate in pleadings."

The court found that "the filing of the complaint and all further prosecution of this action was in violation of the requirements of Rule 11 of the Federal Rules of Civil Procedure *and* the Colorado Statute." (emphasis added). From such judgment, Hall & Evans brought an appeal to the Tenth Circuit.

The court of appeals reversed Judge Matsch's factual findings of misrepresentation and intent and the district court's imposition of sanctions. From such reversal, SM&R and the Fund petition this Court.

REASONS FOR GRANTING THE PETITION

The court of appeals did not abide by the explicit guidance provided by this Court for review of a Rule 11 sanctions award. The appellate court refused to affirm sanctions notwithstanding the clear and undisputable misrepresentations and omissions in the pleading filed. The practical result of the court of appeals decision is to permit intentional misrepresentation of facts by attorneys to fall outside the scope of Rule 11 when the complaint may otherwise assert some plausible legal theory. Moreover, the Tenth Circuit's opinion erodes the trial court's authority to require and enforce candor in the pleadings signed by attorneys who appear before them.

The appellate panel, while acknowledging the "abuse of discretion" standard of *Cooter & Gell v. Hartmarx Corp.*, 110 S.Ct. 2447 (1990), in actuality simply disregarded the factual findings made by the district court. The district court found that Swift misrepresented the facts in the complaint which he drafted, signed and filed. It is impossible to square such a finding with the appellate holding that an award of sanctions in such circumstances abuses a trial judge's discretion. (App. 17a-18a).

The court of appeals held that since (in its view, not the district court's) a plausible legal theory had been asserted, it was improper for the district court to impose sanctions. However, the simple issue presented is whether a district court is empowered to penalize a clear violation of the duty of candor and accuracy in pleadings. The Ninth Circuit Court of Appeals recognized such a duty in *Pipe Trade Council v. Underground Contractors Association*, 828 F.2d 609 (9th Cir. 1987).

Commentators have, not surprisingly, voiced their opinion that "allowing the deliberate deception of the Court and opposing counsel about critical facts would be totally inconsistent with the letter and the spirit of Rule 11."[1] However, the Tenth Circuit has now allowed a challenged pleading to be justified by what has been termed a 'post-hoc' slight of hand.[2] In this case, the plausible theory cited by the appellate court was not contained in the complaint, but rather asserted after SM&R requested that sanctions be imposed. An absolution of a pleading containing such deceptions, on any grounds, erodes Rule 11 and the ability of the trial courts to curb abusive tactics.

Judge Matsch, in a very detailed analysis of the case, ordered sanctions under both Rule 11 and the Colorado state statute. Judge Matsch made specific factual findings which cannot be set aside unless clearly erroneous. Rule 52, Fed. R. Civ. P. The court of appeals erred in disregarding the trial court's factual findings that Mr. Swift knew facts quite different from the allegations made in the complaint and that the factual allegations of the complaint misrepresented relevant facts existing at the time the complaint was filed.

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[1] See Schwarzer, *Rule 11 Revisited*, 101 Harv. L. Rev. 1013 (1988); Note, *Plausible Pleadings: Developing Standards for Rule 11 Sanctions*, 100 Harv. L. Rev. 630 (1987); See also *Itel Containers International Corp. v. Puerto Rico Marine Management, Inc.*, 108 F.R.D. 96, 102 (D. N.J. 1985)

[2] See *In Re: Ronco*, 105 F.R.D. 493, 498 (N.D. Ill. 1985), appeal dism'd., 793 F.2d 295 (7th Cir. 1986).

A. THE DISTRICT COURT BELIEVED THAT SWIFT FILED THE COMPLAINT FOR AN IMPROPER PURPOSE.

The district court held that it was clear that the Bank could not sue Willard Forman and/or Bell on the M&W Note after the execution of the Agreement. (App. 9a) Accordingly, since the Agreement provided that the Bank had to proceed in the legal action only through a summary judgment motion, Judge Matsch determined that the Bank and its lawyers hoped to collect something from the Fund and SM&R without going to the full expense of a trial (App. 9a). The district court cited this improper use of the judicial system in finding that Swift violated Rule 11. It is not proper for a litigant to file a complaint with no intention of proceeding to a trial of the merits. Such use of the judicial system can only be characterized as harassment within the meaning of Rule 11.

B. COURTS OF APPEALS MUST GIVE DEFERENCE TO TRIAL COURTS' FACTUAL FINDINGS.

As this Court recently emphasized in *Cooter & Gell*

> "if the district court's account of the evidence is plausible in light of the record viewed in its entirety, the court of appeals may not reverse it even though convinced that had it been sitting as trier of fact, it would have weighed the evidence differently. Where there are two permissible views of the evidence, the factfinder's choice between them cannot be clearly erroneous."

110 S.Ct. at 2458 citing *Inwood Laboratories v. Ives Laboratories*, 456 U.S. 844, 857-858, 102 S. Ct. 2182, 72 L.Ed. 2d 606

(1982). In practice the "clearly erroneous standard" requires the appellate court to uphold any district court factual determination that falls within a broad range of permissible conclusions. *Cooter & Gell*, 110 S.Ct. at 2458.

This Court's strong stance of deference to the district court was apparently motivated by its recognition that district courts must make an assessment of the signer's credibility. The district court must judge the violations of the rule in light of the entire tenor of the case. As Judge Matsch noted " . . . the factual allegations of the complaint in this case are a misrepresentation of the relevant facts at the time the complaint was filed." (App. 8a) The Agreement expressly canceled the note which the Bank's attorneys attached, uncanceled, to the original complaint. Since this case was on file for over a year and one-half and live testimony was presented to the district court, the court of appeals was not well positioned to determine the "flavor" of the litigation in reviewing the factual findings. Accordingly, the Tenth Circuit erred in disregarding the factual findings of the district court.

C. A MISREPRESENTATION OF THE FACTS IN A COMPLAINT CANNOT BE JUSTIFIED UNDER *ANY* LEGAL THEORY.

The court of appeals apparently believed that since the Agreement acknowledged the Bank's status as a holder of the certificate, that the Bank's attorneys could file a complaint which misrepresented facts. Judge Matsch did not hold that there was no legal theory upon which the Bank could have proceeded, but rather that the allegations in the complaint misrepresented the true facts

affirmatively and through material omissions. The issue of whether a plausible theory existed does not justify violations of Rule 11.

This Court has expressly held that Rule 11 must be interpreted to give effect to the rule's central goal of deterrence. *Cooter & Gell*, 110 S.Ct. at 2454. The fact that a cause of action is plausible under some legal theory meets only part of the test contained in Rule 11. Such complaint must also be well grounded in fact. Accordingly, where a complaint misrepresents the facts of an action, it still violates Rule 11 even though there may be a legal theory upon which a party could rely. Trial judges must have broad discretion to sanction attorneys who misrepresent or conceal material facts in pleadings regardless of the merits of their clients' claims. The integrity of the pleading process, and in some ways the value of Rule 11, depend on it. This issue is worthy of this Court's consideration so that there is a uniform set of guidelines for the lower Courts to follow.

CONCLUSION

In light of the misrepresentations contained in the complaint and the bad faith intent of the Bank's counsel in filing the complaint, the district court ordered appropriate sanctions under Rule 11 and the Colorado statute. Supporting the imposition of sanctions by the district court were specific factual findings regarding the misrepresentations and the bad faith intent.

The court of appeal's decision improperly reversed all factual findings without discussing whether such findings were clearly erroneous. Accordingly, such decision misapplies the standards and policies identified by this Court in reviewing sanctions under Rule 11. As this Court expressed in *Cooter & Gell* deference must be given to the district court's factual finding. In light of this deference, Petitioners submit that a misrepresentation of facts cannot be condoned regardless of the existence of a possible legal theory.

Accordingly, for the foregoing reasons, Petitioners request that this Petition for Writ of Certiorari be granted and the decision of the court of appeals for the Tenth Circuit be reversed.

DATED: December 17, 1990

Respectfully submitted,

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APPENDIX

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Civil Action No. 87-M-439

COLONIAL NATIONAL BANK,

Plaintiff,

v.

SECURITIES MANAGEMENT & RESEARCH, INC. and AMERICAN NATIONAL INCOME FUND, INC.,

Defendants.

MEMORANDUM OPINION AND ORDER

(Filed Dec. 27, 1988)

MATSCH, Judge

This civil action was initiated by a complaint, filed March 26, 1987, which contained the following allegations:

> 7. That on or about January 28, 1986, Plaintiff made a loan to M & W Enterprises in the sum of Sixty Thousand Dollars ($60,000) in accordance with the terms of a promissory note dated January 28, 1986, attached hereto as Exhibit A and made a part hereof by reference.
>
> 8. That M & W Enterprises, pledged Share Certificate A 221 for Four Thousand Two Hundred and Fifteen Shares (4,215) of the capital stock of Defendant American National Income Fund, Inc. as security and collateral for the loan.
>
> 9. That on or about the 28th day of July, 1986, the M & W Enterprises' loan, represented by Exhibit A, matured.

10. That Plaintiff, by letters dated the 23rd day of July, 1986, a copy of which is attached and marked as Exhibit B, made demand upon M & W Enterprises, Willard E. Forman, and Marilyn K. Bell for repayment of the loan represented by Exhibit A. M & W Enterprises, Willard E. Forman, and Marilyn K. Bell failed and refused to repay the loan.

11. That on or about the 13th day of August, 1986, Plaintiff forwarded Share Certificate A 221 (Exhibit C, attached hereto) for Four Thousand Two Hundred and Fifteen (4,215) shares of the stock of Defendant American National Income Fund, Inc. to Defendant Securities Management and Research, Inc. for sale, with the proceeds to be paid to Plaintiff.

12. That Defendants failed and refused to sell or transfer the share certificate, Exhibit C, and contrary to Plaintiff's instructions, cancelled the share certificate on or about August 21, 1986, and marked said certificate "VOID."

13. That Share Certificate A 221, attached as Exhibit C, was valued at Twenty-four Dollars and Fourteen Cents per share for each of Four Thousand Two Hundred and Fifteen (4,215) shares, for a total of One Hundred One Thousand Seven Hundred Fifty Dollars and Ten Cents ($101,750.10), as of the 13th day of August, 1986, being the date that Plaintiff requested payment for said shares from Defendant Securities Management and Research, Inc.

14. That Securities Management & Research, Inc., as agent for Defendant American National Income Fund, Inc., has failed and refused to pay Plaintiff the value represented by said shares.

Upon those allegations, Colonial National Bank ("Bank") asserted claims from Securities Management &

Research, Inc. ("SMR"), for breach of an agreement with plaintiff, breach of duty to the plaintiff as a third party beneficiary, negligence in failure to follow the plaintiff's instructions and breach of a contract of pledge/bailment as well as a "negligent and wrongful cancellation of shares of the stock." The plaintiff claimed against American National Income Fund, Inc. ("Fund") as a principal, responsible for the conduct of its agent, SMR. The prayer for relief sought damages of $101,750.10, plus interest, attorney's fees, costs and expenses and included the following paragraph:

> C. That the plaintiff be awarded attorneys' fees, costs, and expenses of litigation in accordance with C.R.S. 13-17-101, *et. seq.*, against both Defendants and their attorneys for willfully maintaining frivolous and unmeritorious defenses to this ligitation for such other and further relief as to the Court may seem proper.

The complaint was signed by Clinton P. Swift and Richard M. Lucas of the law firm of Hall and Evans.

Before signing that complaint, Mr. Swift knew facts quite different from the allegations made. Willard Forman was the shareholder and principal officer of Canfield Roofing, Inc., a corporation engaged in the business of a roofing contractor, which was indebted to the Bank on loans to the Bank and overdrafts on its checking account in January, 1986. David Wade, President of the Bank, was the officer dealing with Mr. Forman. M & W Enterprises was created in January, 1986, as a partnership of Willard Forman and Marilyn Bell. Marilyn Bell was the secretary-treasurer and office manager of Canfield Roofing. She was living with Willard Forman, who was separated from his wife, Charmaine. On January 28, 1986, the Bank made

a loan in the form of a line of credit of $60,000 to M & W Enterprises, evidenced by a promissory note signed by Forman and Bell. As collateral for that loan, Willard Forman gave the Bank possession of stock certificate A 221, dated October 28, 1980, evidencing the ownership of 4,215 shares of American National Income Fund, Inc., a mutual fund, by Willard Forman and Charmaine Forman, joint tenants. The proceeds of the loan to M & W Enterprises went to reduce the indebtedness of Canfield Roofing to the Bank.

In July, 1986, the Bank called the M & W loan and sought to foreclose on the collateral. Willard Forman gave David Wade a blank assignment of stock, signed by Willard Forman on August 13, 1986. That document also contained the apparent signature of Charmaine A. Forman. On August 13, 1986, Melinda Smith of Boettcher and Company wrote a letter to SMR, forwarding the certificate with the attached stock power and directing SMR to liquidate the shares on behalf of Colonial National Bank. That letter was received by SMR. It cancelled the certificate, marking it void, and notified the Bank, by letter of September 8, 1986, that the certificate became null and void in 1984 at the time that Willard Forman liquidated his account with the fund. On September 24, 1986, Mr. Swift wrote a letter to SMR, asserting that in the opinion of Hall and Evans, the refusal to remit the proceeds or return the original certificate was unlawful and demanding payment for 4,215 shares of the fund. Shortly before that letter was written, David Wade had talked with Willard Forman and his attorney about the validity of the certificate and Forman had insisted that SMR was making

an accounting error and that he did indeed have an interest in the fund.

On November 25, 1986, a settlement agreement was signed by the bank, M & W Enterprises, Canfield Roofing, Willard E. Forman and Marilyn K. Bell, individually. That document was drafted by Clinton Swift and Michael Bahr, who was then representing Willard Forman. The recitals in the agreement included the following:

> WHEREAS, the Bank, despite tender of the Certificate for redemption, has been unsuccessful in collection of money due from Securities Management & Research ("SMR") resulting from closure of Forman's account and errors in the SMR accounting process;
>
> WHEREAS, a dispute has arisen between the Bank and Forman, Bell and M & W regarding misrepresentation and fraud in connection with the delivery of the Certificate as security for the Loan;
>
> The terms of settlement include the following:
>
> (i) The Bank shall cancel the Note and allow Forman and Bell to execute and deliver a new promissory note in its stead ("New Note") in the principal amount of Thirty-nine Thousand Twenty Dollars ($39,020.00) bearing an interest of Eleven and one-half percent (11-1/2%) amortized over a fifteen (15) year term with a "balloon payment" occurring at the end of the seventh (7th) year of the New Note requiring payment in full of all principal and all accrued but unpaid interest thereon (a copy of which New Note is attached hereto as Exhibit "A" and by this reference incorporated herein).
>
> (ii) The Bank shall accept as security for the payment of the New Note, a deed of trust

evidencing a second lien position on that certain real property ("Property") commonly known as 9028 Hillview Road, Morrison, Colorado ("Deed of Trust").

(iii) The Bank shall apply any and all proceeds received by the Bank under Paragraphs 1(b)(i) and 1(c)(i) hereinbelow against the amounts due under the New Note and thereafter to be applied against amounts due to the Bank under the Loans; application of such proceeds shall be made against the Loans in any manner and order as the Bank shall in its sole discretion determine.

(iv) With respect to the claim of the Bank as a holder in due course of the Certificate, the Bank shall pursue collection from SMR by the initiation of a civil action which action shall include as a minimum, the filing of a complaint and a motion for summary judgment regarding the same; provided, however, the Bank shall be under no obligation whatsoever to maintain and continue such action beyond the foregoing or following any adverse ruling of the motion for summary judgment. If the Bank determines in its sole discretion to discontinue the action, the Bank shall, upon the written request of Bell, assign its rights, title and interest over to Bell to continue the action.

(v) At such time as the New Note has been paid in full, the Bank shall release the Deed of Trust, and thereafter upon payment in full of all the Loans if any other security remains in the possession of the Bank, the same shall be released. The Bank acknowledges and agrees that upon payment in full of the New Note, Bell has no further obligations to the Bank and the Deed of Trust shall act only as security for the New Note.

(vi) As further consideration for the New Note, the Bank shall withhold and refrain from assertion of any and all claims it has against Forman regarding fraud and/or misrepresentation in connection with the delivery of the Certificate as security for the Note so long as payment of the New Note is made in a timely manner. Upon payment in full of the New Note, the Bank will waive any and all claims it has against Forman for Fraud and/or misrepresentation.

(vii) The Bank covenants and agrees not to assert or attempt to assert any fraud and/or misrepresentation claims regarding the Certificate against Bell, in any event or at any time.

The real estate securing the new loan was owned by Marilyn Bell and her mother. The new loan was not in default when the complaint was filed.

The deposition of Marilyn Bell was taken on December 9, 1987. She testified that she signed the name of Charmaine Forman on the stock power pursuant to the request of Willard Forman. On March 1, 1988, the plaintiff filed a motion to dismiss all claims for relief, without prejudice, reciting that during the course of discovery, plaintiff discovered facts "not previously known which weigh against further prosecution of this matter." This court then issued its order to show cause under F.R.Civ.P. 41(a)(2). The defendants responded by asserting that the complaint was substantially frivolous and that the complaint should be dismissed with prejudice and with the condition that the plaintiff pay attorney's fees and costs in the amount of $58,356.32. The plaintiff contested that and a trial was held, pursuant to a pre-trial order of June 15, 1988, on the question of whether dismissal should be

conditioned upon the payment of attorney's fees and costs under Rule 11 and Rule 41(a)(2) of the Federal Rules of Civil Procedure, 28 U.S.C. § 1927 and C.R.S. §§ 13-17-101 to 106.

The Bank and Hall and Evans have had separate representation in this dispute and it is the Bank's position that it relied on counsel in pursuing this action. Hall and Evans and the Bank take the position that there was no knowledge of the forgery of Charmaine Forman's signature on the stock power until Marilyn Bell testified to it in her deposition. They also assert that the Bank took the stock as a holder in due course when the note was given for the loan in January, 1986. Therefore, they argue that this action was prosecuted in good faith and that the Bank still has a valid litigating position to seek one-half of the value of the shares as of the time of the demand under the Boettcher letter. An expert witness testified in support of that position on the assumption that the settlement agreement did not cancel the M & W note. It is argued that whether the note was to be cancelled is a question of fact and whether the bank was a holder in due course is also a question of fact which could have legitimately been litigated in this case.

That argument avoids the unpleasant fact that the factual allegations of the complaint in this case are a misrepresentation of the relevant facts at the time the complaint was filed. Nothing in the complaint says or suggests that the note evidencing the obligation to be secured by the collateral claimed on was the subject of a settlement agreement with its makers which by its express terms cancelled the obligation. There is no factual question concerning the intent of the parties to that

agreement. It is clear that the Bank could not sue Willard Forman and/or Marilyn Bell on the M & W note after the execution of the settlement agreement. It is also clear that the Bank and its lawyers hoped to collect something from the Fund and SMR without going to the full expense of a trial. It is this court's finding that Clinton Swift violated Rule 11 when he signed a complaint which failed to disclose the settlement agreement. Half truths are not appropriate in pleadings.

Additionally, it is this court's finding that reasonable inquiry by counsel would give sufficient information to preclude good faith reliance on the bona fide purchaser position. The president of the Bank knew that Willard Forman was separated from his wife and living with his business partner, Marilyn Bell. He also knew that the Canfield Roofing Company was in desperate financial circumstances, having failed to pay on its loans and having developed a very substantial obligation to the Bank as a result of overdrafts on the checking account. There is more than a reasonable basis for suspicion concerning the validity of Charmaine Forman's signature authorizing the Bank to take as collateral what is, on its face, stock in which she is a joint tenant and for an obligation which could not possibly be for her benefit. Additionally, the Bank guaranteed the signatures on the stock power, without direct knowledge of the validity of Charmaine's signature. Finally, the technical legal position of the Bank is flawed. The pledge of the stock was incomplete in January, 1986, when the loan was made. It was not until the stock power was signed in August, 1986, that the Bank could proceed on the security in bearer form. Thus, it is this court's view that the Bank could not be a purchaser

or holder for value until August, 1986, and at that time, the Bank had full knowledge of the issuer's position that the certificate was invalid and that Willard Forman had no interest in the Fund.

There is nothing in this record to suggest that the Bank withheld any information from its counsel or misled the lawyers in this case. Accordingly, it is this court's view that the full responsibility for the prosecution of this civil action is on counsel. The filing of the complaint and all further prosecution of this action was in violation of the requirements of Rule 11 of the Federal Rules of Civil Procedure and the Colorado statute. Accordingly, what remains is the determination of reasonable attorneys' fees and costs. These are sought for services performed by Greer, Foutch, Herz and Adams of Galveston, Texas, primary counsel for the defendants, and Kirkland & Ellis, local counsel for the defendants prior to the Rule 11 dispute and by Holland & Hart, counsel for the defendants in the Rule 11 dispute.

The services performed by primary counsel include matters before the bankruptcy judge in the bankruptcy of Willard Forman. In a bankruptcy settlement agreement, Willard Forman agreed to pay the Fund and SMR $8,000 which should be credited against the claim being made in this civil action. On December 2, 1988, Brooke Jackson filed an affidavit for the fees of Holland & Hart in the representation of the defendants in the matter now before the court. Plaintiff's Exhibit 40 is an invoice of earlier services and disbursements. It is this court's view that the total of $8,009.96 is reasonable and it will be allowed. Kirkland & Ellis served as local counsel throughout this matter and plaintiff's Exhibit 39 reflects its billings. The

total of $12,801.37 is a reasonable fee for the services performed which the court finds to be necessary in the representation of the defendants in this action and accordingly is allowed. Greer, Foutch, Hertz [sic] and Adams and its predecessor, Dibell [sic] and Greer, have made charges for services which are plaintiff's Exhibit 37. They total $60,861.42. John Buckley, an attorney from that firm, testified that this should be reduced by $3,000.00 for matters not related to this litigation and improperly included. Accordingly, the claim is for $57,861.42. He also testified that the arrangement with the client was that all attorneys would be billed at $90 per hour for 1986, $93.60 in 1987 and $98.25 in 1988, regardless of the experience and expertise of the particular lawyers performing services. Additionally, a flat rate was charged for paralegals for each year in the amounts of $30 in 1986, $31.20 in 1987 and $32.76 in 1988. This arrangement was made because the firm served as general counsel to this client. There are 22-1/2 hours shown for legal research on the attorney-client privilege and there is duplication because two lawyers attended depositions. There are 40 hours shown for the preparation of a third party complaint, which is excessive. Counsel testified that about 20% of the time was spent in performing services in connection with the bankruptcy of Willard Forman. Willard Forman listed the certificate for shares as an asset of the bankruptcy estate. The services performed were in support of an objection to discharge, seeking damages resulting from this lawsuit. That is different from defending the meritless claims in this action. It is this court's view that the 20% should, therefore, be deducted from the claim and that an additional 80 hours should be deducted as duplicative and

excessive. Using the $90 hourly rate, that reduction is $7,200. The 20% adjustment yields a reduction of another $11,572. Accordingly, it is this court's finding that a reasonable fee for the services of Greer, Foutch, Hertz [sic] and Adams is $39,089.00. Thus, the total award for attorney's fees and expenses is $59,900.33 from which $8,000 must be deducted, leaving the amount of the award at $51,900.33.

Upon the foregoing, it is now

ORDERED that as a condition to the dismissal of this civil action, Hall and Evans shall pay to the defendants, Securities Management & Research, Inc. and American National Income Fund, Inc. the sum of $51,900.33.

Dated: December 27th, 1988

BY THE COURT:

/s/ Richard P Matsch
Richard P. Matsch, Judge

UNITED STATES DISTRICT COURT

DISTRICT OF COLORADO

COLONIAL NATIONAL BANK,

Plaintiff,

v.

SECURITIES MANAGEMENT & RESEARCH, INC. and AMERICAN NATIONAL INCOME FUND, INC.,

Defendants.

JUDGMENT IN A CIVIL CASE

(Filed Dec. 27, 1988)

CASE NUMBER 87-M-439

[ ] Jury Verdict. This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

[ ] Decision by Court. This action came to trial or hearing before the Court. The issues have been tried or heard and a decision has been rendered. Pursuant to memorandum opinion and order entered by Judge Richard P. Matsch on December 27, 1988,

IT IS ORDERED AND ADJUDGED

that this civil action is dismissed with prejudice and judgment is entered in favor of Securities Management & Research, Inc. and American National Income Fund, Inc., and against Hall and Evans, P.C. in the amount of $51,900.33.

December 27, 1988
Date

JAMES R. MANSPEAKER
Clerk

/s/ Glenna Bloxson
(By) Deputy Clerk

Case Number: 87-M-439

I certify that I mailed a copy of the attached to the following:

Dated: December 27, 1988

JAMES R. MANSPEAKER, CLERK

BY: /s/ Glenna Bloxson
Jacob Gilmore, Deputy Clerk
Glenna Bloxson, Secretary

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UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

COLONIAL NATIONAL BANK, a national banking association, Plaintiff, v. SECURITIES MANAGEMENT & RESEARCH, a Texas corporation; and AMERICAN NATIONAL INCOME FUND, INC., a Texas corporation, Defendants-Appellees, and CHARMAINE FORMAN; MARILYN BELL; and M & W ENTERPRISES, Defendants,	)	No. 89-1024 (D.C. No. 87-M-439) (D. Colo.)
THE LAW FIRM OF HALL & EVANS and CLINTON P. SWIFT, Appellant.	)	

ORDER AND JUDGMENT*
(Filed July 11, 1990)

*This order and judgment has no precedential value and shall not be cited, or used by any court within the Tenth Circuit, except for purposes of establishing the doctrines of the law of the case, res judicata, or collateral estoppel. 10th Cir. R. 36.3.

Before ANDERSON, BARRETT, and BALDOCK, Circuit Judges.

After examining the briefs and appellate record, this panel has determined unanimously that oral argument would not materially assist the determination of this appeal. *See* Fed. R. App. P. 34(a); 10th Cir. R. 341.9. Accordingly, appellants' request for oral argument is denied, and the case is ordered submitted without oral argument.

Hall & Evans and Clinton P. Swift, counsel for plaintiff Colonial National Bank (CNB), appeal from a sanction order issued by the district court requiring them to pay defendants' attorneys' fees in the amount of $51,900.33. We review the order for an abuse of discretion. *Adamson v. Bowen*, 855 F.2d 668, 673 (10th Cir. 1988).

The district court's memorandum opinion indicates that the sanction was imposed on counsel for drafting a complaint that was factually misleading and legally unwarranted. For the reasons related briefly below, we cannot agree with either characterization of CNB's pleading.

The primary factual matter prompting the district court's concern involved the omission of any allegation disclosing CNB's settlement agreement with Willard Forman, which substituted a new note for the obligation secured by the stock certificate upon which CNB's cause of action rested. Since the settlement agreement also expressly acknowledged CNB's continuing legal status as holder of the certificate and its right to pursue an action

for recovery thereon, the existence of the settlement agreement did not affect the rights and obligations of the parties and, therefore, was not material to the present action. Omission of the matter from the complaint could not, under the circumstances, be cause for sanction.

With respect to the legal sufficiency of CNB's complaint, the district court identified the weakness of CNB's position under the principles governing the rights of bona fide purchasers against adverse claimants under Colo. Rev. Stat. § 4-8-302. However, CNB sought recovery on the certificate against the *issuer* (and its transfer agent) as a purchaser for value without notice of defect under Colo. Rev. Stat. § 4-8-202 and § 4-8-208. Without expressing an opinion on the ultimate merits of such a claim, which in light of the unappealed prejudicial dismissal of CNB's action has been rendered moot, we do note that this facially valid claim is not subject to the defect identified by the district court in connection with section 4-8-302. *See generally* § 4-8-202 Official Comment; § 4-8-301 Official Comment 1; § 4-8-307 Official Comment 1.

The order of the United States District Court for the District of Colorado, insofar as it directs plaintiff's counsel to pay defendants' attorneys' fees, is REVERSED.

ENTERED FOR THE COURT
PER CURIAM

UNITED STATES COURT OF APPEALS

FOR THE TENTH CIRCUIT

COLONIAL NATIONAL BANK, a national banking association, Plaintiff, v. SECURITIES MANAGEMENT & RESEARCH, a Texas corporation; and AMERICAN NATION INCOME FUND, INC., a Texas corporation, Defendants-Appellees, and CHARMAINE FORMAN; MARILYN BELL; and M & W ENTERPRISES, Defendant, THE LAW FIRM OF HALL & EVANS and CLINTON P. SWIFT, Appellants.	No. 89-1024 (Filed Sept. 18, 1990)

ORDER

Before HOLLOWAY, Chief Judge, BARRETT, McKAY, LOGAN, SEYMOUR, MOORE, ANDERSON, TACHA, BALDOCK, BRORBY, and EBEL, Circuit Judges.

This matter is before the court on appellees' petition for rehearing with suggestion for partial rehearing en banc.

The materials submitted by appellees have been reviewed by the members of the hearing panel, who conclude that the original disposition was correct. Accordingly, the petition is denied on the merits.

The petition having been denied on the merits by the panel to whom the case was submitted, the suggestion for rehearing en banc was transmitted to all the judges of the court in regular active service in accordance with Rule 35(b) of the Federal Rules of Appellate Procedure. No member of the hearing panel and no judge in regular active service on the court having requested that the court be polled on rehearing en banc, Rule 35, Federal Rules of Appellate Procedure, the suggestion for rehearing en banc is denied.

Entered for the Court
ROBERT L. HOECKER, Clerk
/s/ Patrick Fisher
BY: Patrick Fisher
Chief Deputy Clerk